

Dockets: 2009-1150(EI)
2009-1151(CPP)

BETWEEN:

J.R. SAINT & ASSOCIATES
INSURANCE AGENCIES LTD.,

Appellant,

and

THE MINISTER OF NATIONAL REVENUE,

Respondent.

Appeals heard on common evidence on December 15, 2009,
at Calgary, Alberta.

Before: The Honourable Justice Robert J. Hogan

Appearances:

Counsel for the Appellant: Gordon D. Beck

Counsel for the Respondent: Marla Teeling

JUDGMENT

The appeals from the decision of the Minister of National Revenue (the “Minister”) dated March 20, 2009, confirming the assessments dated July 16, 2008, are allowed and the said assessments are varied and referred back to the Minister for reconsideration and reassessment on the basis that only the biweekly payments received by Nicolas Anstis, Kevin Lundy and Shannon MacDonald from the Employee Profit Sharing Plan during the 2006, 2007 and 2008 taxation years were insurable income and insurable earnings from insurable employment pursuant to section 82 and paragraph 5(1)(a) of the *Employment Insurance Act* and pensionable income and pensionable earnings from pensionable employment under section 12 and paragraph 6(1)(a) of the *Canada Pension Plan*, in accordance with the attached reasons for judgment.

Signed at Ottawa, Canada, this 23rd day of March 2010.

“Robert J. Hogan”

Hogan J.

Citation: 2010 TCC 168
Date: 20100323
Dockets: 2009-1150(EI)
2009-1151(CPP)

BETWEEN:

J.R. SAINT & ASSOCIATES
INSURANCE AGENCIES LTD.,

Appellant,

and

THE MINISTER OF NATIONAL REVENUE,

Respondent.

REASONS FOR JUDGMENT

Hogan J.

Introduction

[1] The Appellant set up the Employee Profit Sharing Plan (the “EPSP”) on January 1, 2006 for Nicolas Anstis, Kevin Lundy, Shannon MacDonald and James Saint, all employees of the Appellant (the “Employees”). Following the establishment of the EPSP, the Employees’ salary and wages were reduced to a nominal amount and the balance of their remuneration was paid to them through distributions from the EPSP funded by the Appellant. The Appellant admits that the purpose of the EPSP was to eliminate the *Canada Pension Plan* (“CPP”) and employment insurance (“EI”) premiums payable on salary and wages. Payments to employees from an employees profit sharing plan are treated as trust income, and not salary and wages, under the *CPP* and EI program.

[2] The Respondent argues that the EPSP was a sham (the “Sham Argument”) because the Appellant caused salary and wages due and payable to the Employees to transit through the EPSP for the purpose of misleading the Minister of National Revenue (the “Minister”) into believing that the payments made by the EPSP to the Employees were trust distributions. According to the Respondent, the payments were in fact salary and wages that were due and payable to the Employees.

Issues

[3] The issues in these appeals are:

- (a) whether the Appellant misrepresented the circumstances surrounding the establishment and operation of the EPSP, thus making the EPSP a sham for the purposes of the *CPP* and the *Employment Insurance Act* (the “*EIA*”);
- (b) if the EPSP is a sham, whether the amounts received by the Employees thereunder are employment income and therefore pensionable and insurable income for the purposes of the *CPP* and the *EIA*.

[4] At the outset of the trial, the Respondent brought a motion to amend its Reply to the Notice of Appeal (the “Amended Reply”) by the abandonment of its argument that the EPSP was not properly constituted, as a consequence of which the Respondent’s case would now be based solely on the Sham Argument. I allowed the amendment and both parties were given the opportunity to make written submissions. Counsel availed themselves of this opportunity.

Factual Background

[5] Following an audit of the Appellant’s EPSP, a referral was made for a trust account examination to be performed on the Appellant’s books and records. On the basis of that examination, the Minister determined that payments made to the Employees from the EPSP during the 2006, 2007 and 2008 taxation years were pensionable income and pensionable earnings from pensionable employment under section 12 and paragraph 6(1)(a) of the *CPP* and insurable income and insurable earnings from insurable employment pursuant to section 82 and paragraph 5(1)(a) of the *EIA*.

[6] As a result of that decision, the Minister assessed the Appellant for *CPP* contributions plus related penalties and interest, as follows:

Year	Amount	Penalty	Interest
2006	\$12,972.74	\$1,673.89	\$2,348.00
2007	\$11,340.08	\$1,563.52	\$627.00
2008	\$2,733.90	\$198.64	\$95.00

[7] The Minister also assessed the Appellant for EI premiums plus related penalties and interest, as follows:

Year	Amount	Penalty	Interest
2006	\$4,266.16	\$1,673.89	\$2,348.00
2007	\$4,795.20	\$1,563.52	\$627.00
2008	\$1,252.70	\$198.64	\$95.00

[8] The appeals from those assessments were heard on common evidence.

[9] The Respondent stated in paragraph 14 of the Amended Reply that it had relied on the following assumptions of fact in making its decision:

- (a) the Appellant is in the Business of providing financial services and insurance (the “Business”);
- (b) the Appellant’s fiscal year is from January 1 to December 31;
- (c) the Appellant’s shareholders and their percentages of holdings are:
 - 2006
 - James Saint 51%
 - Saint Family Trust 49%
 - 2007 to present
 - James Saint 100%;
- (d) James Saint is the President of the Business;
- (e) for the relevant period, the Workers were employed by the Appellant under a contract of service;
- (f) the Workers’ positions are as follows:
 - Shannon MacDonald Executive Assistant
 - Kevin Lundy Sales and Administration
 - Nicolas Anstis Financial Advisor;
- (g) the Appellant had five employees in 2006, five in 2007 and four in 2008;
- (h) the Appellant set up a trust (“the Trust”) on January 1, 2006 by entering into an agreement;
- (i) the Trustees of the Appellant’s “Trust” are James Saint, James McIntyre and Daryl Phippan;
- (j) James McIntyre and Daryl Phippan were not active in the management of the funds;
- (k) the realized net income is to be allocated to the Participants prior to the end of the year via written direction from the Board of Directors;
- (l) pursuant to the Appellant’s Resolutions, the allocations were to be as follows:

- Resolution dated December 23, 2006, the amount of \$386,146.86 are [sic] to be paid by December 31, 2006
 - Shannon MacDonald: \$47,026
 - Kevin Lundy: \$33,369
 - James Saint: \$233,740
 - Nicolas Anstis: \$72,010
- Resolution dated December 23, 2007, the amount of \$163,736.88 are [sic] to be paid by December 31, 2007
 - Shannon MacDonald: \$52,979
 - Kevin Lundy: \$38,646
 - James Saint: \$0.00
 - Nicolas Anstis: \$72,110

(m) the Workers received the following T4 employment income from the Appellant:

Name	2005	2006	2007
Nicolas Anstis	\$40,499	\$6,153	\$64,356
Kevin Lundy	\$34,384	\$5,000	\$4,500
Shannon MacDonald	\$46,499	\$6,384	\$4,500
James Saint	\$230,000	\$3,975	\$294,406

- (n) in 2006, the Workers received an annual nominal amount between \$3,975 and \$6,384 on which deductions were taken through the Appellant's regular payroll;
- (o) in 2007, the Workers received an annual nominal amount between \$1,500 and \$4,500 on which deductions were taken through the Appellant's regular payroll;
- (p) the Workers received additional income from the Appellant as follows:

Name	2006	2007
Nicolas Anstis	\$124,964	\$72,110
Kevin Lundy	\$33,369	\$38,646
Shannon MacDonald	\$47,026	\$52,979
James Saint	\$280,000	\$0.00
Total	\$485,359	\$163,736.88

(q) in 2006, the percentage of additional income compared to T4 income was as follows:

Name	2006 T4 income	2006 additional income	Percentage
Shannon MacDonald	\$6,384.62	\$47,026.50	726.56%
Kevin Lundy	\$5,000	\$33,369	667.38%
James Saint	\$3,975.00	\$280,000	7,044.03%
Nicolas Anstis	\$6,153.85	\$124,964.37	2,030.67%

(r) in ~~2006~~ 2007, the percentage of additional income compared to T4 income was as follows:

Name	2006 <u>2007</u> T4 income	2006 <u>2007</u> additional income	Percentage
Shannon MacDonald	\$4,500.00	\$52,979.75	1,177.33%
Kevin Lundy	\$4,500.00	\$38,646.25	858.81%
James Saint	\$294,406.00	\$0.00	0.00%
Nicolas Anstis	\$64,356.76	\$72,110.88	112.05%

- (s) the payments referred to in paragraphs (q) and (r) above were not based on any determined formula, and contributions were calculated on an *ad hoc* basis;
- (t) only Nicolas Anstis, Kevin Lundy, Shannon MacDonald and James Saint received additional income from the Appellant in 2006 and 2007;
- (u) the Appellant reported on its financial Balance Sheet, Retained Earnings, as follows:

2005	\$1,141,436
2006	\$906,921
2007	\$1,230,669

- (v) the Appellant reported on its financial Income Statement, Profit, as follows:

2005	\$229,866
2006	\$371,313
2007	\$492,699

- (w) the Appellant reported on its financial Income Statements and on its corporate returns the amounts paid to the Workers as salaries and wages;
- (x) the Workers were paid all income through a bank account number 1093656 in the name of “J.R. Saint & Associates Insurance Agencies Ltd.” at Manulife Bank (the “J.R. Saint & Associates Insurance Agencies Ltd. account”);
- (y) the Appellant had signing authority and managed the account of J.R. Saint & Associates Insurance Agencies Ltd. account [*sic*];
- (z) the J.R. Saint & Associates Insurance Agencies Ltd. account reported the following:
 - debits and credits of \$4,936.11 were processed on a bi-weekly basis for 19 months from February to August 2006
 - debits of \$4,936.11 and credits of \$5,000 were processed on a bi-weekly basis for 19 months from September 2006 to March 2007
 - debits of \$3,196.67 and credits of \$5,000 were processed on a bi-weekly basis for 7 months from April to October 2007
 - debits of \$3,196.67 and credits of \$3,200 were processed on a bi-weekly basis for 7 months from November 2007 to May 2008
 - effective January 2007, the \$5,000 credits were pre-authorized automatic transactions
 - credits were transferred from Manulife Bank account number 1025234, the business corporate account;

(aa) during the [*sic*] 2006, 2007 and 2008, the total contributions and withdrawals to the “J.R. Saint & Associates Insurance Agencies Ltd.” bank account were as follows:

Years	Contributions	Withdrawals
2005 <u>2006</u>	\$479,233.32	\$482,427.18
2006 <u>2007</u>	\$185,000.00	\$161,657.63
2007 <u>2008</u>	\$35,200.00	\$35,163.37

(bb) none of the funds contributed to the J.R. Saint & Associates Insurance Agencies Ltd.’s bank account were invested.

[10] James Saint appeared as the sole witness for the Appellant. During his testimony, he admitted that the purpose of the EPSP was to allow the Employees to receive a substantial part of their compensation in the form of distributions from the EPSP rather than as salary and wages. As a result, most of the income earned by the Appellant’s Employees in 2006, 2007 and 2008 was not subject to withholdings for EI or *CPP* premiums. Mr. Saint alleged that the primary factor in determining the total contribution to the EPSP was the desire to ensure that the Appellant did not report net income in excess of the amount eligible for the small business rate of taxation. The evidence shows that this was true for the contributions made to the EPSP that were allocated to Mr. Saint. However, with respect to Nicolas Anstis, Kevin Lundy and Shannon MacDonald, the evidence shows that the situation was otherwise. In fact, during cross-examination Mr. Saint admitted that, with respect to those other employees, he looked at what their remuneration for their services would have been for the year and divided it by 26 to come up with the amount that was paid to them through the EPSP in lieu of salary and wages.¹

[11] Counsel for the Appellant confirmed that this was how Mr. Saint determined the biweekly payments (the “biweekly payments”) made by the EPSP to Nicolas Anstis, Kevin Lundy and Shannon MacDonald:

MR. BECK: Sorry. It's not disputed that commencing in 2006, upon the purported EPSP, that salaries that otherwise would have been – otherwise would have been paid directly to employees were flowed through the EPSP.

I think my Mr. Saint's answer is essentially bi-weekly amounts were determined based on what the same employees would have received had there been no EPSP, or alternatively, based on what those employees received in years that there was no EPSP.²

Analysis

¹ Trial transcript, page 72, lines 20 to 24.

² *Ibid.*, page 73, lines 3 to 12.

[12] By agreement of the parties, I can dispose of these appeals by deciding whether or not the EPSP set up by the Appellant constitutes a sham in whole or in part. Before addressing the Respondent's Sham Argument, it is useful to consider the meaning of "employees profit sharing plan", which is defined in subsection 144(1) of the *Income Tax Act* (the "*ITA*") as follows:

144(1) Definitions — The definitions in this subsection apply in this section.

"employees profit sharing plan" at a particular time means an arrangement

(a) under which payments computed by reference to

(i) an employer's profits from the employer's business,

(ii) the profits from the business of a corporation with which the employer does not deal at arm's length, or

(iii) any combination of the amounts described in subparagraphs (i) and (ii)

are required to be made by the employer to a trustee under the arrangement for the benefit of employees of the employer or of a corporation with which the employer does not deal at arm's length; and

...

[13] The following three conditions must be met in order for an arrangement to meet the requirements of this definition:

- (a) payments must be computed by reference to the profits of the employer's business;
- (b) those payments must be handed over to a trustee under the arrangement; and
- (c) all amounts received by the trustee must be allocated each year by the trustee to the employees that are beneficiaries under the arrangement.

[14] At this point, it should be noted that the Appellant also relies on an election that was made under subsection 144(10) of the *ITA*. That provision provides relief from the condition that payments into an EPSP must be computed by reference to profits, and reads as follows:

144(10) Payments out of profits — Where the terms of an arrangement under which an employer makes payments to a trustee specifically provide that the payments shall be made "out of profits", the arrangement shall, if the employer so elects in prescribed manner, be deemed, for the purpose of subsection (1), to be an arrangement under which payments computed by reference to the employer's profits are required.

[Emphasis added.]

[15] A valid subsection 144(10) election has the effect of the “computed by reference to . . . profits” requirement being deemed to be satisfied if the terms of the plan provide, for example, for fixed payments to be made into the plan out of the profits of the employer. There is in that case no need for the payment into the plan to be determined by means of a formula-based calculation.

[16] This brings us to a consideration of the concept of sham in Canadian tax law. One of the leading cases on the subject is the decision of the Federal Court of Appeal (the “FCA”) in *2529-1915 Québec Inc. v. Canada*.³ In that case, the FCA distinguishes the concept of sham from the notion of abuse. The notion of abuse is relevant for the purpose of the general anti-avoidance rule found in section 245 of the *ITA*, which is not applicable in the present case. The FCA concludes that a transaction can be set aside under the concept of sham if the evidence shows the existence of the requisite element of deceit:

59 It follows from the above definitions that the existence of a sham under Canadian law requires an element of deceit which generally manifests itself by a misrepresentation by the parties of the actual transaction taking place between them. When confronted with this situation, courts will consider the real transaction and disregard the one that was represented as being the real one.

[17] The Appellant argues that the onus of proof as it pertains to the concept of sham rests with the Respondent. It is not open to the Respondent to rely on the assumptions of fact contained in paragraph 14 of the Amended Reply to support its position. The Respondent must establish the factual underpinnings of a sham in the case at bar on the basis of the evidence. I agree with the Appellant on this point only with respect to paragraph 14.1, which was added in the Respondent’s Amended Reply. The Respondent can rely on the assumptions of fact pleaded in paragraph 14 of the Respondent’s Reply and carried over into the Amended Reply. That paragraph was amended to correct clerical errors only. In fact, some of those assumptions of fact are germane to the Respondent’s Sham Argument.

[18] I believe that the Trust Indenture executed to establish the EPSP contains a number of misrepresentations of fact. Section 1 of the preamble to the Trust Indenture provides the following:

The Company desires to establish an Employee Profit Sharing Plan pursuant to Section 144 of the Income Tax Act (the “Plan”) for the benefit of the Eligible Beneficiaries in order to permit the Eligible Beneficiaries to share in the profits of the Company;

³ 2008 FCA 398.

[Emphasis added.]

[19] Similarly, article 2 of the Trust Indenture defines the purpose of the EPSP as follows:

The Company contributes the Trust Assets to the Trustees for the benefit of the Participating Beneficiaries identified in this Trust Indenture.

[20] Paragraph (j) of article 1 of the Trust Indenture defines “profits” as follows:

“Profits” means the net income of the Company arrived at by following generally accepted accounting practices as determined from the financial statements of the Company for the fiscal period in question.

[Emphasis added.]

[21] From the Trust Indenture, it can be seen that the salient features of the EPSP are the following:

- (a) The purpose of the EPSP is to allow eligible employees to participate in the Appellant’s profits.
- (b) The Appellant has absolute discretion to determine the amount of its contribution to the EPSP subject to a minimum contribution equal to 1% of profits.
- (c) Contributions to the EPSP must be made out of the Appellant’s accumulated profits as defined in the EPSP.

[22] The evidence shows that these principles were not adhered to with respect to the contributions made to fund the biweekly payments made by the EPSP to Nicolas Anstis, Kevin Lundy and Shannon MacDonald (the “Non-shareholder Employees”). Prior to the creation of the EPSP, the Appellant was obliged to pay the Non-shareholder Employees’ salary and wages on a biweekly basis. Shannon MacDonald and Kevin Lundy’s salaries were a fixed amount plus a small bonus. Nicolas Anstis provided investment advice to clients and his remuneration was based on a formula that took into account his contribution to the Appellant’s earnings. Following the creation of the EPSP, the Appellant offered the Non-shareholder Employees the opportunity to receive a substantial portion of their compensation through biweekly payments from the EPSP. The Non-shareholder Employees accepted this arrangement and received from the EPSP biweekly payments which were characterized by the Appellant in its tax filings as trust distributions. The sum of these biweekly payments and the nominal annual salary amount constituted the employees’ remuneration for their employment services for the relevant period. While none of the Non-shareholder Employees were called as witnesses by the

Appellant, Mr. Saint and his counsel admitted that part of the Non-shareholder Employees' normal employment compensation was paid through the EPSP.⁴ There is other evidence which corroborates this fact. The unaudited financial statements of the Appellant for the periods under review characterize the contributions paid out of the EPSP as salaries and benefits deductible in the calculation of the Appellant's net income for financial statement purposes. Exhibit A-5 appears to be an Excel spreadsheet that tracks the payments made to the Employees from the EPSP. The title on the spreadsheet describes the payment summary as the "EPSP Payroll". At trial, I asked Mr. Saint whether Mr. Anstis would be entitled to claim the amounts accrued to his account but not yet payable in the event that he was terminated without cause. Mr. Saint confirmed that he would be entitled to claim all such amounts. I surmise that the other Non-shareholder Employees would be entitled to similar treatment. In other words, their vacation pay and severance claims would be based on the sum of the amount shown to be their nominal salary and the amount of all the biweekly payments received from the EPSP. As regards these payments, there was nothing discretionary about the Appellant's contribution to the EPSP. The evidence shows that the payments were required in order for the Appellant to fulfill its obligations towards its employees. The Appellant was in a position to call the Non-shareholder Employees to testify concerning their understanding of the character of the payments made to them under the EPSP. I draw a negative inference from the fact that they were not called to testify on this point. As salary, the biweekly payments could not form part of the Appellant's accumulated profits as defined in the Trust Indenture. The amounts of those payments were deductible in the calculation of the Appellant's profits, as shown in the Appellant's unaudited financial statements. Profit is the amount that remains after the deduction of all expenses incurred to earn revenue.

[23] Counsel for the Appellant argues that my colleague Porter D.J. considered a similar EPSP arrangement in *Allan A. Greber Professional Corporation v. M.N.R.*, 2004 TCC 78, and arrived at a conclusion different than my own. In *Greber*, the Minister agreed that the EPSP was a valid and properly constituted plan. The Minister did not advance the "Sham Argument" in that case. In the present case, the Minister argues that misrepresentations of fact were made by the Appellant in the Trust Indenture for the purpose of causing the Minister to believe that the EPSP distributions were trust distributions whereas there was an agreement that these payments were owed for services rendered.

[24] I agree with the Minister's interpretation of the evidence as it concerns the biweekly payments made out of the EPSP. The same analysis, however, cannot be applied either to lump-sum payments, if any, made to the Non-shareholder Employees, or to the amounts paid to Mr. Saint in 2006 out of the EPSP. Mr. Saint,

⁴ Trial transcript, page 51, line 9, to page 61, line 1; page 73, lines 3 to 12.

as the controlling shareholder of the Appellant, can, unlike the Non-shareholder Employees, cause the corporation to pay him dividends on the shares he owns, or he can draw remuneration in the form of salary and bonuses. He alone can determine the quantum of each type of distribution. As the controlling shareholder and managing director of the corporation, Mr. Saint does not require a formal employment agreement to define his entitlement as an employee of the corporation. All accumulated and undistributed profits accrue indirectly to Mr. Saint's account as the sole shareholder of the corporation.

[25] The evidence shows that Mr. Saint received two separate large payments from the EPSP in fiscal year 2006. This evidence does not support the Respondent's allegation that salary and wages otherwise owing to Mr. Saint were simply routed through the EPSP. The form of payment is more consistent with the fact that profits of the Appellant were shared with Mr. Saint through contributions made to the EPSP by the Appellant.

Conclusion

[26] For all of these reasons, the assessments are referred back to the Minister for reconsideration and reassessment on the basis that only the biweekly payments received by Nicolas Anstis, Kevin Lundy and Shannon MacDonald from the EPSP for the 2006, 2007 and 2008 taxation years were insurable income and insurable earnings from insurable employment pursuant to section 82 and paragraph 5(1)(a) of the *EIA* and pensionable income and pensionable earnings from pensionable employment under section 12 and paragraph 6(1)(a) of the *CPP*.

Signed at Ottawa, Canada, this 23rd day of March 2010.

"Robert J. Hogan"

Hogan J.

CITATION: 2010 TCC 168

COURT FILE NOS.: 2009-1150(EI), 2009-1151(CPP)

STYLE OF CAUSE: J.R. SAINT & ASSOCIATES INSURANCE
AGENCIES LTD. v. THE MINISTER OF
NATIONAL REVENUE

PLACE OF HEARING: Calgary, Alberta

DATE OF HEARING: December 15, 2009

REASONS FOR JUDGMENT BY: The Honourable Justice Robert J. Hogan

DATE OF JUDGMENT: March 23, 2010

APPEARANCES:

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